Division of Agricultural Sciences
UNIVERSITY OF CALIFORNIA

What You Should Know About

Farm Leases

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This circular aims at helping tenants and landlords in drawing up mutually satisfactory leases. The farm lease worksheet sample (see center insert) may be torn out and used to help you determine an equitable rent for your individual lease situation.

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WHAT YOU SHOULD KNOW ABOUT FARM LEASES

Tenants operate approximately 13 per cent of California farms, but 63 per cent of the land is leased. Included are all types of agricultural enterprises. Rental rates and leasing arrangements vary widely, depending on type of enterprise, productivity, size, location, and the like.

Leasing arrangements must be tailored to each individual case but should be based on a mutual feeling of trust, a satisfactory potential income for tenant and landlord, a rental rate equitable to both parties, and a written lease using clear, understandable words. In short, good farm leases

- are periodically reviewed to determine if they are equitable,
- are based, if necessary, on some form of sliding-scale rent (described herein) to reduce undue risk to either tenant or landlord,
- provide for an automatic renewal unless terminated by either party,
- are in writing—to protect you, your heirs, and your tenant.

WHAT TO INCLUDE

Legal advice will help prevent subsequent difficulties. In general, every lease should contain at least the following:

Date of lease.

Names and addresses of all parties concerned.

Description of the property—

Location as to county and state,
Legal description,
Acreage,
Specification of parcels of land or buildings being retained by the landlord.

Terms of lease—

Dates of start and termination of the lease,
Provision for automatic continuation on a year-to-year basis unless termination notice is given by either party before a specified date,
Rental rates for each enterprise,
Expenses to be borne by each party concerned,
How, when, and where rent is to be paid,
Management practices to be followed for:
  Acreages of crops
  Rotations
  Numbers of livestock
  Improvements,
Provision to reimburse tenant at termination of lease for improvements made at his expense and not fully used up,
Provision for settlement in case of death,
Provision for arbitration in case of disagreement.

Signatures of all parties.

LEGAL REQUIREMENTS

A lease is a contract, a promise enforceable by law.

A valid contract must meet certain legal requirements. Among them are:

Consent of the parties. All parties to be bound by the contract must consent positively. Lack of a negative answer cannot bind a person to a contract.

Parties competent to enter into contract. Persons under 18 generally do not have full legal capacity to make contracts; neither do insane persons, intoxicated persons, and convicts. Corporations, by their charter, may have limited contracting power.

Consideration is the price which one party pays for another's promise. The price need not be in terms of money but is essentially the conduct, or the promise of conduct, of one party given in exchange for the conduct, or promise of conduct, of the other party to the transaction.

Purpose of the contract must be legal.

Contracts which cannot be performed within one year must be in writing to be enforceable.

Under California law, leases of land for agricultural purposes for a period longer than 51 years are not valid.

DETERMINING THE RENT

Rent, being the price for the use of land or other productive factors, is determined by demand and supply. There are, however, many reasons why it is difficult for tenant and landlord to arrive at and to maintain a rental arrangement fair to both.

Rents often become established at a "customary" rate. But there are situations where no customary rate has been established, such as for enterprises which have not normally been rented, or for new enterprises developed in an area.

But also in situations where customary rates have been established, tenants and landlords will do well to constantly reappraise the existing rates, or they may find themselves at a disadvantage. Rental rates should respond to changes in cost-price relationships, introduction of new machinery, development of higher-yielding varieties, production shifts from one area to another, increasing farm size, need for greater managerial ability, and others.

This circular cannot, of course, determine the rent for you. This is your job to be done by individual bargaining. This circular, however, presents to you a method that will assist you in arriving at equitable rental rates.

An equitable rent, as usually defined, is one where landlord and tenant share the gross income in the same proportion as they contribute to the costs of production. To establish a fair rent:

FARM LEASE WORKSHEET

Owner | Tenant | Date

Farm

INVESTMENT EXPENSE

	Total Investment	Landlord			Tenant		
		Investment	Interest	Depreciation	Investment	Interest	Depreciation
Land							
Buildings							
Irrigation system							
Fences							
Trees, vines, crops							
Tractors & trucks							
Machinery							
Harvest equipment							
Livestock							
Operating capital							
TOTAL							

DISTRIBUTION OF EXPENSE

	Total value	Landlord		Tenant	
		Description	Value	Description	Value
NONCASH COSTS					
Interest					
Depreciation					
Unpaid labor					
Management allowance					
CASH COSTS					
Hired labor (cultural)					
Hired equipment					
Contract work					
Herbicide					
Dust					
Seed					
Fertilizer					
Spray material					
Gas & oil					
Repairs					
Water or power					
Harvest					
Feed					
Veterinary					
Supplies					
Hull & dry					
Taxes					
Insurance					
Office expense					
Dwelling					
Other					
TOTAL COSTS					
Per cent	100				

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Determine the contributions made by each party,

Assign appropriate values to these contributions,

Establish the share of the total costs contributed by landlord and tenant.

List the following contributions in some logical manner. Use of a form like the farm lease worksheet (center insert) may be helpful.

Noncash Costs

Investment. The capital or investment furnished by each party is made a part of annual costs by including interest on such investments. Figure land at a sound agricultural value. Few agricultural tenants can pay a rent which reflects subdivision values. Figure buildings, equipment, and other depreciable facilities at current depreciated values, or at about half of the replacement cost. Include only necessary items and only at values which would ordinarily provide adequate facilities. Neither party should include investments of unnecessary or overly expensive buildings and equipment. Figure interest on the total investment of each party at an agreed-upon rate, such as 6 or 7 per cent. Interest actually paid on debts by either party is ordinarily not considered; such outlays are covered by total interest on the investment.

Depreciation. The annual decline in value of buildings, irrigation system, equipment, trees, and other capital investments through use or increasing age is a proper part of annual costs. Estimate depreciation by dividing cost of each facility by probable useful life.

Unpaid labor. Make an allowance for the actual operator and family labor furnished by each party at going wage rates and include it in the total costs.

Management allowance. This may also be a proper part of total costs; if so, list it under distributions of expenses divided in the same way as the landlord and tenant share in the managerial duties and responsibilities. Management can be valued on the basis of charges made by professional managers—for example, 5 per cent of the gross income for actual management, or 10 per cent where the manager also defrays costs of office facilities, accounting, travel, and other expenses associated with management.

Cash Costs

Credit each party with production, harvesting, and overhead cash expenses paid by that party. These costs may be estimated from previous records, from recent cost studies, or from cost standards, such as enterprise data sheets, available from such sources as the University of California Agricultural Extension Service. These expenses are important, so considerable care and local inquiry are justified.

Dwelling

A dwelling furnished by the landlord and used by the tenant can be included in the investment of the landlord. In this case, interest and depreciation plus cash costs of taxes, repairs, and insurance would be credited as annual costs contributed by the landlord.

It is, however, preferable to keep the dwelling completely separate from the contributions of the landlord, and include a provision that the tenant pay a cash rent for its use. This method separates the home from the business, and places a market value rental on its use rather than tying the house rent to the productivity of the farm.

The Final Computation

After listing the annual contributions of landlord and tenant, add each list and determine the proportion which each party contributes to the total production cost.

The percentage contributed by the landlord can be used as the share rent, or it can be multiplied by the probable price to arrive at a cash rent. If the percentage

FARM LEASE WORKSHEET

Owner John Doe Tenant R Roe Date

Farm Processing tomatoes on an acre basis - Woodland area

INVESTMENT EXPENSE

	Total Investment	Landlord			Tenant		
		Investment	Interest at 4%	Depreciation	Investment	Interest at 4%	Depreciation
Land	$900	$900	$63				
Buildings	15	15	2				
Irrigation system			6				
Fences							
Trees, vines, crops							
Tractors & trucks						$30	
Machinery							
Harvest equipment						47	
Livestock							
Operating capital							
TOTAL			$71			$77	

DISTRIBUTION OF EXPENSE

	Total value	Landlord		Tenant	
		Description	Value	Description	Value
NONCASH COSTS					
Interest	$148		$71		$77
Depreciation					
Unpaid labor					
Management allowance	29				29
CASH COSTS					
Hired labor (cultural)	57				57
Hired equipment	3				3
Contract work	2				2
Herbicide	6				6
Dust					
Seed	15				15
Fertilizer	11				11
Spray material	33				33
Gas & oil	20				20
Repairs					
Water or power	15				15
Harvest	170				170
Feed					
Veterinary					
Supplies					
Hull & dry					
Taxes	17		17		
Insurance	19				19
Office expense					
Dwelling					
Other					
TOTAL COSTS	$545		$88		$457
Per cent	100		16		84

of the costs furnished by the landlord is too far from the usual or "customary" share, and it is desired to use the customary rate, some of the contributions may be shifted from one party to the other to make the percentages fit the local rental rate. Changing the contribution from one party to the other may also equalize the risks borne by the landlord and tenant or contribute to more efficient use of some resources, e.g., where fertilizer cost is divided between the parties.

This method does not determine what the exact rent should be, but provides a guide as to what the rent might be. The exact rent must be determined by bargaining between the parties, considering prevailing local rates.

A Sample Worksheet

The worksheet for a tomato lease shown above illustrates the procedure that can be used to determine an equitable rent of 16 per cent. Although this rate is the prevailing one, current rents range from 15 to 20 per cent, depending primarily on what the landlord furnishes.

Sliding Scale or Flexible Rents

Many landlords and tenants find a sliding scale or flexible rent desirable. Under these arrangements, the amount of cash rent or the percentage of share rent varies with price, yield, or income. In some cases, the rent varies in direct proportion to the change in price, yield, or income; other arrangements include some arbitrary deviation from the direct relationship. Usually, rent variations accompanying changes from a direct relationship between rent and price result in the landlord assuming a larger share of the risk associated with price or yield drop than would otherwise be the case. The landlord is able to stand this risk because a larger proportion of his contributions to the business is noncash.

Sliding-scale cash rent. Under this system, the cash rent is usually set to vary with the price of the product. A basic rental rate is usually established at some stipulated selling price. Then provisions are made for set increases or decreases in the rent as prices rise or fall. The actual rent is determined only after the commodities are sold and the actual selling price is known. Where several marketing outlets are available, it may be desirable to base the rent on some established and well recognized market quotation for the product rather than on the actual selling price. This protects the landlord from poor marketing practices by the tenant, and gives the tenant the advantage when he does a particularly good job of marketing.

The amounts of rent actually paid under these systems do not necessarily change in direct proportion to the changes in price. In many cases they are set up so that proportionately less rent is paid at low prices and higher rent at high prices.

Sliding-scale share rent. Since the actual rent collected by the landlord under a share rent agreement varies proportionately with the yield and with the price, there is not a great deal of interest in a sliding scale share rent. However, this method is used in some areas of relatively high risk.

A sliding-scale share rent is based on price or on yield. If based on price, the share rent is established at some given price, and goes up or down with the actual price received.

For example, the 16 per cent rent in the tomato example given on page 6 might be established at a price of $30 per ton. If the price increased to $32, the rent might be 17 per cent or, if the price dropped to $15, the rent would be 15 per cent. There is periodic interest in this type of rental rate but very few actual leases are drawn up on this basis.

A sliding-scale share rent based on yield is more common, particularly in areas of rather frequent near failures of the crop. Usually the tenant pays no rent if the yield drops below some predetermined level, and the share rent gets progressively higher as the yield increases.

A variation to the above is where no rent is paid below a certain yield level, but above this point the rent is higher than that indicated by the method of determining equitable rents.

Sliding-scale share rents have to be based on some arbitrary agreement, because these arrangements are a deviation from the equitable rent which would be obtained by using the method described

earlier. These arrangements can be defined as equitable only in terms of easing the burden of the tenant under conditions of low price or low yield. They represent protection against unusual, but potentially disastrous, income hazards.

DEVELOPMENT LEASES

The method which we have described for determining annual rent can also be used to determine the rent under a development lease. The inputs of the landlord and the tenant can be accumulated during the development period, after which they become a part of the contribution during the rent-paying period with depreciation and interest being charged over the rent-paying period of the lease.

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